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## Dispute Settlement in the WTO: *Mind Over Matter*

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Dispute Settlement in the WTO.  
*Mind over Matter*

Petros C. Mavroidis



European University Institute  
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## **Abstract**

The basic point I advocate in this paper is that the WTO Dispute Settlement System aims to curb unilateralism. No sanctions can be imposed, unless if the arbitration process is through, the purpose of which is to ensure that reciprocal commitments entered should not be unilaterally undone through the commission of illegalities. There are good reasons though, to doubt whether practice guarantees full reciprocity. The insistence on calculating remedies prospectively, and not as of the date when an illegality has been committed, and the ensuing losses for everybody that could or could not be symmetric, lend support to the claim that the WTO regime serves 'diffuse' as opposed to 'specific' reciprocity. Still, WTO Members continue to routinely submit their disputes to the WTO adjudicating fora, showing through their behaviour that they would rather live in a world where punishment is curbed, than in world where punishment acts as deterrent since full reciprocity would be always guaranteed.

## **Keywords**

WTO; dispute settlement; diffuse reciprocity

**JEL Classification:** K40





## 1. The Argument\*

The negotiators of the DSU<sup>1</sup> aimed at establishing a ‘rules-based’ system, that is, an adjudication regime whereby disputes would be resolved exclusively by independent judges, and not through unilateral action. The established regime would aim at removing disputes from the docket, if possible, or adjudicate them in impartial manner. If bilateral resolution fails, then the only way to resolve disputes would be through submission to an independent adjudicator. Losing parties will be called to comply with adverse rulings, or face retaliation equaling the damage inflicted through the illegal act. The framers nonetheless, did not manage to agree on a clear method that would guarantee that reciprocity would be respected. They used terms such as ‘substantially equivalent concessions’, indicating reciprocity, a few times in the text, without however providing for a clear methodology that will always guarantee this outcome.

In practice, it is at best doubtful whether reciprocity has been observed, and yet WTO courts, twenty years following their advent, continue to be the busiest courts litigating state-to-state disputes. This leads me to conclude that what seems to have mattered, and still matters, most to WTO Members was the spirit of cooperation in adjudication, the establishment of a process to curb unilateralism. The one element that is consistently present in every stage of the process is that no unilateral qualification of illegality should ever take place. This is the exclusive privilege of WTO judges. WTO members were thus, prepared to sacrifice some of their belongings in order to keep the system in place as is.

To substantiate the basic point I make above, I look into two sources, namely, the negotiating history of the DSU, and dispute adjudication practice. In my view, it is imperative that these two elements are taken on board in a paper that aims to understand the preferences of the world trading community with respect to dispute adjudication. Negotiating history can help us understand the preferences of players that were outspoken about their preferences. Practice is relevant because preferences might change over time.

The rest of the paper is organized as follows. In Section 2, I discuss the negotiating record, not the full record of course, but the parts relating to the quintessential elements of the process established, as well as the discussion on remedies in case of breach of obligations. It is here that I aim to establish that the DSU framers were unanimous in their quest to curb unilateralism, but not so unanimous when it came to providing a methodology for quantification of damages in case of contractual breach. The main point here is that, in name at least, the agreement calls for respect of reciprocity, without however, providing for a mechanism to ensure that this will always be the case. Section 3 describes in a matter of factual manner the outcome of the negotiation, the DSU. It is in this Section that I will provide the procedural framework that will entertain requests for dispute adjudication. Section 4 is where I discuss case law to make the point that panels, in light of the divergence of views between various WTO Members regarding the quantification of damages, opted for a very ‘conservative’

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<sup>1</sup> DSU stands for ‘Dispute Settlement Understanding’, the WTO Agreement administering the dispute settlement system (DSS) of the WTO. In this paper, I look into the WTO in ‘self contained’ manner. WTO Members might use ‘sticks’ and ‘carrots’ from other areas of international relations in order to enforcement of WTO obligations. They have little (if any) incentive to publicly reveal similar information, and, as a result, it is impossible to (dis-)prove similar claims. Analytically, everything becomes very complicated (if not quixotic) if we were to view trade disputes within the (highly realistic) wider realm of inter-state relations.

approach that, de facto, sides with the views of those opposed to full compensation of damages. Section 5 is the ‘plat de resistance’ where I explain why, in my view, the current regime for remedies as practiced in WTO does not guarantee respect of full reciprocity, and why it comes closer to what political scientists call ‘diffuse reciprocity’. The idea here is that, while the balance of commitments is not fully redressed, WTO members expect that deviations will be addressed through the same process in comparable terms. It is more of a process obligation aiming to curb unilateral responses to (perceived) illegalities, rather than a means for removing the incentive to commit illegalities because of the ensuing competence to pay back all proceeds of the illegal act. Section 6 contains the main conclusions of this paper.

## **2. The Uruguay Round and the Birth of the DSU**

Arts. 1, 22.4, and 23.2 DSU capture the essence of the WTO dispute settlement, the quintessential elements of which have been described above. These provisions reflect the extent of agreement, but not how we ended up with it. To do this, we have to delve into the negotiating record.

### ***2.1 Uruguay to Geneva: The Makings of the DSU***

Three basic conclusions emerge from the study of the negotiating record. First, there was widespread agreement to design a system that would eliminate the threat of unilateral action à la ‘Section 301’, the legal instrument through which US would unilaterally prosecute illegal (in its view) behavior by its trading partners. Second, negotiators managed to design a system of compulsory third party adjudication, and thus, avoid ‘system failure’ if defendant refused to consent to establishment of a panel, the GATT/WTO ‘court’. In this vein, they agreed that WTO judges would be exclusively competent to decide on whether an illegality had been committed. This was the price to pay for obliging the US to accept that it would use Section 301 not as instrument for self-help, but as instrument for representing ‘private’ complaints before WTO where private parties have no standing. Third, negotiators could not bridge their differences regarding the remedies that would be appropriate to address illegalities. While they stated clearly that, if need be, countermeasures could not supersede the damage inflicted, they did not provide for a specific mechanism that would ‘quantify’ damage. This issue as well was left to WTO judges.

#### **2.1.1 Background of the Negotiation**

The negotiation of the DSU did not take place on a vacuum, but against a background of 40 years of GATT litigation.

Hudec (1993) provides a comprehensive account of dispute settlement during the GATT years. The main conclusions of his study could be described as follows. The GATT became de facto compulsory third party adjudication, since with one exception all requests for establishment of a panel were met affirmatively, and over 80% of all reports issued were adopted. We do not know of course, how many times potential complainants, for fear of seeing their request rejected, shirked requests for establishment.<sup>2</sup> There is no reliable record of compliance with adverse rulings but, with few exceptions (like the notorious ‘Chicken War’ in the ‘60s), spiralling of countermeasures was constrained for the best part of the GATT-era, that is including the negotiation of the Tokyo round, even though no provision to this effect had ever been inserted in the GATT. Following the end of the Tokyo round (1979) the picture changes. A number of Panel reports remained un-adopted, and a few times recourse to un-authorized countermeasures takes place as well. The change is due to many factors. First, around that time, the US decided it was high time it challenged the consistency of the

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<sup>2</sup> Point picked up by negotiators MTN.GNG/NG13/16 of November 13, 1989.

EU CAP (common agricultural policy) with the GATT rules. For fear that it might be questioning the quintessence of the EU integration process, the US had refrained from attacking the CAP, privileging a negotiating solution. When this did not happen during the Tokyo round, and/or in order to force similar solution during the Uruguay round, the US initiated a number of challenges against the CAP, and the EU refused to 'legitimize' the Panel reports (and thus, weaken its negotiating position during the round) by adopting them. Second, the US also initiated a number of 'Section 301' actions against a host of GATT members. Some of them in an effort to affect the negotiating agenda of the Uruguay round (the so-called 'Super 301' in the area of intellectual property), and some in order to show its displeasure with the long delays in attributing justice in the GATT, and the possibility to block hostile reports.<sup>3</sup> Finally, a series of panels in the '80s dealt specifically with the remedies issue in the context of contingent protection. They all faced claims to the effect that antidumping (countervailing) duties had been illegally imposed. Echoing the standard in customary international law, panels recommended that orders imposing duties be revoked and all illegally perceived duties be reimbursed.<sup>4</sup> The defendant was either the EU or the US, and all but one report remain un-adopted. The EU and the US expressed their disagreement with panels' findings to the effect that retroactive remedies were appropriate, an issue that was very much under discussion during the Uruguay round, which had already been initiated by that time (1986).

In his study as in other work,<sup>5</sup> he has made a very persuasive case of how GATT 'pragmatism' helped evolve the system to de facto compulsory third party adjudication. The overwhelming majority of GATT members shared the view that pragmatism was the key ingredient. In this view, GATT dispute adjudication:

did not provide for judicial settlement of international trade disputes, ... was primarily of conciliatory nature ... a rule-oriented approach enabling legally binding interpretations should not be viewed as a hindrance to conciliatory settlement ... main objective ... the avoidance or speedy resolution of disputes.<sup>6</sup>

A GATT Secretariat document issued early on during the Uruguay round confirms that this was the 'acceptable' view, to which all GATT members more or less could subscribe.<sup>7</sup> This 'idyllic' view of GATT dispute adjudication was disturbed by the emergence and re-invigoration through successive statutes of Section 301. Hudec's (1993) study shows that de facto we were living in a compulsory third party adjudication world. Only one request for establishment of a panel was rejected and it involved, alas, the US, the instigator of 'Section 301'. It had requested from the EU to submit their '80s dispute regarding trade in hormone-treated beef to a panel. The EU and the US disagreed about the composition of the panel (that is, the identity of panelists) and, as a result, the EU refused to accept the US request.<sup>8</sup> Is one case one case too many? Not so, one is tempted to say, by any reasonable benchmark. Even more so when compared with other international fora: the paradigmatic adjudication in international relations involved the acceptance of a request by the defendant. Defendants routinely rejected similar requests.

The GATT dispute settlement system functioned surprisingly well, especially if we were to take into account its highly imperfect institutional infrastructure. In fact, only two provisions in GATT dealt with dispute settlement, and none of them discussed the institutional design of dispute

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<sup>3</sup> Various contributions in Bhagwati and Patrick (1990) as well, underscore this point.

<sup>4</sup> A Secretariat document, GATT Doc. MTN.GNG/NG13/W/32 of July 14, 1989, discusses all reports. See also, Mavroidis (1993), and Petersmann (1993).

<sup>5</sup> In Hudec (1972), he discusses in most succinct terms the intellectual debate between 'legalists' and 'pragmatists', represented by Jackson (1969), and Dam (1970).

<sup>6</sup> GATT Doc. MTN.GNG/NG13/1 of April 10, 1987. Hudec's (1993) study provides further support to this view.

<sup>7</sup> GATT Doc. MTN.GNG/NG13/W/14 of November 3, 1987.

<sup>8</sup> Meng (1990) discusses this dispute in considerable detail.

adjudication. After all, it was the ITO (International Trade Organization) that was supposed to include elaborate provisions on this score.<sup>9</sup> The last decade of the GATT however, paints a different picture, as stated above. Panel reports remained un-adopted. The number of recourse to unilateral retaliation increased. This marks a break from the past. Why has this been the case?

### 2.1.2 Enter Section 301

It is largely because the US felt frustrated with its inability to reform through negotiations the EU CAP, and to enlarge the coverage of the GATT. It felt that it had been quite generous trying to accommodate the EU integration process within the GATT. The US farm lobby was knocking with increased intensity and frequency on the door of the US administration. It was not alone. US administration was also under pressure by its domestic lobbies to add trade in services, and protection of intellectual property rights to the GATT-mandate. Expansion of disciplines to ‘new’ areas was politically the holy grail for the US government that saw there the potential to balance the high trade deficits that the US was experiencing in the ‘80s. What it could not obtain at the negotiating table, the US tried to obtain through adjudication under the threat of retaliation. This is the story of ‘Section 301’ and its many variances.<sup>10</sup>

## 2.2 Curbing Unilateralism

Section 301 was part of the US Trade Act of 1974. De facto it came to prominence in the ‘80s, the decade that coincides with the preparation and initiation of the Uruguay round proceedings. US uses unilateral enforcement during that era as complement to its negotiation tactics. What it cannot obtain through carrots (reciprocal concessions at the negotiating table), it attempts to obtain through stick (enforcement). This attitude did not go down well with its trading partners.

There is not one single account offered by those who participated in the Uruguay round that does not acknowledge that curbing unilateralism was the overarching objective that trade delegates set for themselves when negotiating the DSU.<sup>11</sup> It is no exaggeration to state that the bulk of the negotiation concerned the ‘price to pay’ for unilateralism to be curbed. Deadlines were worked around the US statutory deadlines, and procedural improvements of all sorts were agreed. Above all, the power of defendant to block the road to adjudication was eliminated. This is how this story unravels.

### 2.2.1 Section 301: Loved in DC, Hated Everywhere Else

Recourse to ‘Section 301’ was considered a welcome change by lobbies in the US, but was met with scepticism, if not plain hostility by the GATT membership. A GATT Secretariat document leaves no doubt as to the ‘reception’ of Section 301 beyond the US border:

No contracting party should resort to counter-measures without the authorization of the CONTRACTING PARTIES.<sup>12</sup>

Those with lesser bargaining power that had paid the price of US unilateralism were particularly vocal in expressing their opposition to ‘Section 301’, and the need to put an end to it and to similar practices as well. The submissions by Nicaragua,<sup>13</sup> and Argentina<sup>14</sup> offer good illustrations to this effect.

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<sup>9</sup> See the relevant discussion in Hudec (1993), Irwin et al. (2008), and Jackson (1969).

<sup>10</sup> Various contributions in Bhagwati and Patrick (1990) deal with the political economy, the legality, and the impact of this instrument.

<sup>11</sup> Paemen and Bentsch (1995); Stewart and Callahan (1998).

<sup>12</sup> GATT Doc. MTN.GNG/NG13/W/14 of November 3, 1987.

<sup>13</sup> GATT Doc. MTN.GNG/NG13/W/15, of November 6, 1987.

As if 'Section 301' was already not enough, the US amended it in 1988 so as to increase its scope. The new statute included provisions on challenges against inadequate (in the eyes of the US) protection of intellectual property rights, even though some of the actions were addressed against countries that did not incur international obligations to this effect. This is the famous 'Super 301'. This provoked renewed hostile reactions by various trading nations, a chorus of reactions indeed. The delegate of the EU, for example:

Expressed grave concerns on behalf of the Community and its member States about the US Omnibus Trade and Competitiveness Act, the gestation of which had for a long time burdened GATT's work, particularly during the delicate period leading up to the Uruguay Round.<sup>15</sup>

The delegate of Japan:

... deeply regretted that this Act, which contained a number of problematic provisions, had come into effect.<sup>16</sup>

The Director General of the GATT at the time, Arthur Dunkel, has been quoted stating that the 1988 amendments constituted:

... the single trade policy initiative which had most galvanized the attention of the international trading community.<sup>17</sup>

The delegates of Australia, Brazil, Canada, Hong Kong, India, Sweden, Switzerland, and Uruguay expressed similar criticism.<sup>18</sup> The US delegate explained why 'Section 301' had been expanded:

A major US objective in the Uruguay Round was to strengthen the GATT as an institution and to extend its jurisdiction, so that it could address more disputes. Until that occurred, the United States had to handle bilaterally unfair trade practices, in areas not covered by GATT rules.<sup>19</sup>

### 2.2.2 The Price to Stop Section 301

Following a series of discussions, and a trial and error period ('Montreal rules', 1989), where compulsory third party adjudication was practised on probationary terms, Art. 23.2 DSU was eventually agreed. It reads:

Members shall:

(a) not make a determination to the effect that a violation has occurred, that benefits have been nullified or impaired or that the attainment of any objective of the covered agreements has been impeded, except through recourse to dispute settlement in accordance with the rules and procedures of this Understanding, and shall make any such determination consistent with the findings contained in the panel or Appellate Body report adopted by the DSB or an arbitration award rendered under this Understanding.

(Contd.) \_\_\_\_\_

<sup>14</sup> GATT Doc. MTN.GNG/NG13/W/17, of November 12, 1987.

<sup>15</sup> GATT Doc. C/M/224 of October 17, 1988 at p. 28.

<sup>16</sup> *Idem* at p. 30.

<sup>17</sup> Quoted by Stewart and Callahan (1998) at p. 2762.

<sup>18</sup> *Idem* at pp. 31ff.

<sup>19</sup> *Idem* at p. 34. The problem with unilateral initiatives of the sort (when one becomes the judge of its own cause) is that judgment risks of course being biased. This is a well-known issue for a long long time, and initiatives to address it and move to third party adjudication have been around since ancient times. Tellingly, the medieval city of Sienna adopted an initiative like this, and Bowsky (1981) explains how the city wanted to separate officials from local ties. Sienna opted for foreign judges, and Bowsky explains in pp. 109ff. the rationale for this decision: 'the prestige, ambition, family connections, and in some cases wealth of these men impelled the oligarchy to keep them out of the Sienese courts and to staff these courts with foreigners, whose lack of local family connections, brief residence in the city, and dependence upon the commune for income would keep them relatively honest.' Wills (2002) argues that this type of thinking inspired Madison, one of the architects of the US Constitution.

This is the quintessential provision in the current DSU, and has been interpreted in various reports consistently as a ban on unilateral self-help. In EC-Commercial Vessels, the panel put it eloquently when it stated in §7.190:

If Members were free to attempt to seek the redress of a violation by trying to achieve unilaterally what could be obtained through the DSU, it is difficult to see how the obligation to have recourse to the DSU could contribute to the ‘strengthening of the multilateral trading system.’

The US thus, agreed to stop unilateral qualifications illegality, and, most importantly, recourse to self-help. What would the US get an exchange? Everything it wanted, is the short answer. The disciplines of the GATT would enlarge so as to include services and intellectual property rights in the post-Uruguay round era. Disputes would be adjudicated fast. Statutory deadlines, and negative consensus, that is, the institutionalized impossibility for defendant to block request for consultations, establishment of panel, adoption of its report, recourse to retaliation when warranted (Arts. 6, 16, 17, 22 DSU reflect this institution), would ensure that this would be the case.

Still, the possibility that defendants refuse to comply could not be eliminated. Negotiations on this issue to which we now turn, reveal discussions both about the forms of remedies, as well as about their level.

### ***2.3 Remedies in Case of Non-Compliance***

The GATT (Article XXIII.2) contained a brief sentence on this issue. Assuming the totality of the GATT membership considered that the circumstances were serious enough to justify such action, they could by consensus authorize the complainant to suspend tariff concessions of a value equivalent to the damage suffered vis-à-vis the recalcitrant defendant. Recourse to this remedy happened only once in the GATT-era, when Netherlands requested and obtained authorization to this effect in 1956. It never though implemented its intent, and did not impose countermeasures against the US.<sup>20</sup>

Negotiators of the DSU aimed to ‘enrich’ this provision, but did not want to make a first resort out of recourse to countermeasures. There was unanimity that the preferred option should be the removal of the illegality. There was further unanimity that compensation and/or suspension of concessions should be temporary measures until removal of the illegality occurred. There was finally, unanimity regarding the level of response to illegalities. It should not be higher than the damage done. And they all agreed that, in the absence of agreement between the parties, it should be an Arbitrator that should decide on the level of permissible retaliation.

There was no agreement as to the calculation of the damage, an issue that was not addressed, neither in Art.19 nor in Art. 22 DSU, and which fatally was left for adjudicators to decide upon. Nothing in these provisions, for example, explicitly discusses whether damages should be calculated from the moment when the illegality has been committed, or from a different point in time. And some were, initially at least, unwilling to allow for ‘automaticity’ when it comes to retaliating against recalcitrant states.<sup>21</sup>

Capping responses to illegalities committed to the level of damage done is akin to stating that reciprocal commitments should not be affected as a result of unilateral (illegal) behaviour. This is of course, not the type of remedy one would seek for if the prime objective was deterrence. Indeed, in some antitrust statutes, where deterrence is the objective sought, violators are called to pay treble damages. The underlying assumption in the GATT/WTO world, is that, by preserving reciprocity (in the sense that violators will not be better off by committing an illegality), the incentive to violate in the

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<sup>20</sup> Pauwelyn (2003) discusses how international law here, but in more general terms as well, can help fill the gaps of the GATT contract. Trachtman (2007) has taken a more nuanced view, arguing against similar constructions. We will return to this issue later in this paper.

<sup>21</sup> They wanted to limit negative consensus to establishment of panels and adoption of reports.

first place will be undermined. We will see whether this assumption is reasonable when we discuss practice.

### 2.3.1 Transatlantic Harmony

EU was in favour of speedy resolution but silent as to the retroactivity of damages.<sup>22</sup> Canada wanted fast implementation, within 6 months from circulation of report, and was in favour of quantifying the damage from the date of circulation of panel/AB report.<sup>23</sup> US as well wanted fast relief, and binding deadlines, and, like the EU, did not offer specific opinions on the calculation of damages.<sup>24</sup> Switzerland was in the same wavelength. It wanted to avoid lengthy processes, and went so far as to state that speedy resolution of disputes removed the necessity for retroactive remedies that it did not want to entertain.<sup>25</sup>

### 2.3.2 Latins Like Retro

Developing countries as well favoured speedy resolution, and some proposed that all disputes should be resolved within 15 months when developing countries complained.<sup>26</sup> In contrast to developed countries, a number of them favoured retroactive remedial action. Damages should be calculated from the moment an illegal measure had entered into force, and both Argentina,<sup>27</sup> and Peru<sup>28</sup> tabled proposals to this effect. Mexico was a bit more nuanced, as it supported remedial action from the date of adoption of measures only if compliance had not occurred within the RPT.<sup>29</sup> Retroactive remedies, in this view, would act as incentive to remove illegalities within the RPT. Mexico also supported the introduction of interim measures, e.g. remedial action between the moment when the final award would be issued, and the moment when implementation would occur. Similar action should take the form of compensation as opposed to suspension of concessions, since compensation, unlike suspension of concessions, increases trade.<sup>30</sup> Compensation could, in principle, take the form of payment in the sense of tariff reductions, or even lump sum payments of monetary funds. Suspension of concessions on the other hand, amounted to increases in tariff duties.

Beyond that, there was not much urgency during the negotiations to propose methods for quantifying damages, as the prime objective should be the removal of illegalities.<sup>31</sup> The EU,<sup>32</sup> and the US as well, issued documents to this effect,<sup>33</sup> and many others endorsed this view.<sup>34</sup>

The Chairman of the negotiating group issued a document that reflected the extent of disagreements on the issue of retroactivity of remedial action.<sup>35</sup>

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<sup>22</sup> GATT Doc. MTN.GNG/NG13/W/44, of July 19, 1990.

<sup>23</sup> GATT Doc. MTN.GNG/NG13/W/41 of June 28, 1990.

<sup>24</sup> GATT Doc. MTN.GNG/NG13/W/6, of June 25, 1987.

<sup>25</sup> GATT Doc. MTN.GNG/NG13/W/8, of September 18, 1987.

<sup>26</sup> GATT Doc. MTN.GNG/NG13/10 of October 10, 1988.

<sup>27</sup> GATT Doc. MTN.GNG/NG13/W/17, of November 12, 1987.

<sup>28</sup> GATT Doc. MTN.GNG/NG13/W/23, of March 3, 1988.

<sup>29</sup> RPT refers to the reasonable period of time within which compliance should occur. RPT is necessary since, for various reasons, immediate compliance might not be on the cards, see GATT Doc. MTN.GNG/NG13/W/42 of July 12, 1990.

<sup>30</sup> GATT Doc. MTN.GNG/NG13/W/26 of June 23, 1988.

<sup>31</sup> GATT Doc. MTN.GNG/NG13/16 of November 13, 1989.

<sup>32</sup> GATT Doc. MTN.GNG/NG13/W/12 of September 12, 1987.

<sup>33</sup> GATT Doc. MTN.GNG/NG13/W/3 of April 22, 1987.

<sup>34</sup> GATT Doc. MTN.GNG/NG13/8 of July 5, 1988.



### 2.3.3 Some Preferred Persuasion

Recourse to retaliation was originally met with a lot of scepticism. Only one favoured automatic authorization to retaliation during the early stages of the negotiation,<sup>36</sup> as most speakers conditioned similar action on prior approval by the GATT membership.<sup>37</sup> Japan<sup>38</sup> and Korea<sup>39</sup> were particularly vocal on this score. Japan issued a separate document explaining why in its view similar action should never take place absent consensus.<sup>40</sup> This is an area where developed countries did not speak with one voice, as US wanted endorsement of an automatic right to retaliate after a specified period of time in case of course defendant had not complied therein.<sup>41</sup> Art. 22 DSU was a victory for the US in this respect, since it conditions recourse to retaliation on the will of the injured party that has prevailed before litigation. There are some conditions regarding the level of retaliation that have to be of course, respected, and we will return to this issue *infra*.

### 2.3.4 The Compromise

The impossibility to agree on the precise level of retaliation led negotiators to the formulation of Art. 22.4 DSU. According to this provision, retaliation should be substantially equivalent to the damage suffered. The manner in which equivalence will be established was left to the discretion of arbitrators, in case the parties could not agree to it.

So, negotiators managed to agree that panels only would adjudicated disputes, and that recalcitrant states refusing to implement adverse rulings could face retaliation up to the damage inflicted. The mechanics of establishing equivalence between damage and retaliation were not spelled out. We now turn to the other, procedural features that would put this basic understanding into place before discussing practice.

## 3. Dispute Adjudication in WTO

The objective of dispute adjudication is stated in clear terms in Art. 3.2 DSU and consists in preserving the rights and obligations of WTO Members. Art. 3.7 DSU states an ordering of preferences so to speak. A mutually agreed solution between the parties to a dispute is always preferable. WTO members should thus, exercise judgment and aim to resolve their disputes in diplomatic manner before submitting them to a panel. If it proves untenable, submission to a panel comes next. Panels, if they agree with the complainant, will recommend that the losing party brings its measures into compliance with its obligations, and may also suggest ways to do so (Art. 19 DSU). Removal of the illegal act is the second best. In case defendant refuses to remove the challenged measure, then two interim measures are at the disposal of WTO members, namely, compensation and/or suspension of concession. Compensation is voluntary, and has happened once. Suspension of concessions requires the respect of certain procedural steps. Injured party will deposit a list with retaliatory measures. In case the defendant does not agree with the proposed list, it can request an Arbitrator (if possible, the original panel) to decide on the level of retaliation.<sup>42</sup> Whereas panel

(*Contd.*) —————

<sup>35</sup> GATT Doc. MTN.GNG/NG13/W/43, of July 18, 1990.

<sup>36</sup> GATT Doc. MTN.GNG/NG13/17 of December 15, 1989.

<sup>37</sup> GATT Doc. MTN.GNG/NG13/19 of May 28, 1990.

<sup>38</sup> GATT Doc. MTN.GNG/NG13/6 of March 31, 1988.

<sup>39</sup> GATT Doc. MTN.GNG/NG13/W/19 of November 20, 1987.

<sup>40</sup> GATT Doc. MTN.GNG/NG13/W/21 of March 1, 1988.

<sup>41</sup> GATT Doc. MTN.GNG/NG13/W/40 of April 6, 1990.

<sup>42</sup> Suspension of concessions must be 'substantially equivalent' to the damage ('nullification and impairment', in WTO-speak) suffered (Art. 22.4 DSU). Since the two instruments have similar function, it is expected that the amount of

decisions are appealable, this one is not. Arbitrators' reports are first and last resort. Suspension of concessions (and/or compensation) should be withdrawn when compliance has occurred. On paper thus, property rules (compliance) are preferred over liability rules (compensation/suspension of concessions).

Deciding on the amount of punishment is, of course, the quintessential, but not the only feature of the regime. The WTO judge, it has been argued,<sup>43</sup> 'completes' the contract by interpreting open-ended terms, and making the resolution of future disputes (more) predictable. This brings us squarely into a discussion of the process that framers put into place.

### **3.1 The Process**

#### 3.1.1 An 'Exclusive' Forum for WTO Members Only

Forum shopping is impossible under the DSU. Furthermore, non WTO Members cannot submit their disputes to the WTO, the DSU being a forum to adjudicate disputes between WTO members only (Art. 23.2 DSU).

The DSB (Dispute Settlement Body) is the WTO organ entrusted with the administration of adjudication, and all WTO members have one delegate to this body. All reports, by panels and the Appellate Body (AB),<sup>44</sup> are submitted to it for adoption. The rules (e.g. Arts. 3.3, 6.1 DSU) leave no doubt that it decides by negative consensus, that is, the will of the complainant suffices to establish a panel/AB, adopt a report, authorize countermeasures.

The WTO process is open to WTO members only, although commitments under the WTO definitely affect the life of private agents. The latter have no standing before the WTO, and to advance their claims they need to first secure the agreement of their government to represent them. The conditions under which WTO members agree to do so are not an issue as far as WTO law is concerned. WTO members can be 'liberal', or 'cautious' when entertaining requests by private agents to represent their interests before a panel. The WTO rules regarding adjudication kick in once a request to launch the process (request for consultation) has been formally submitted.

WTO members retain the monopoly to litigate, but why litigate in the first place? This is a very difficult issue, and there are a few only papers that discuss how disputes can arise in equilibrium.<sup>45</sup> One might be tempted to argue that there is a common understanding of what constitutes a cooperative behaviour, so punishment should occur even in the absence of litigation. This is not so though, in the WTO-context. Theory has explained why the GATT should be viewed as 'incomplete' contract.<sup>46</sup> Under the circumstances, it is difficult to imagine what precisely the common understanding of cooperative behaviour is. The common understanding is the agreement to ask WTO judges to define what cooperative behaviour is based of course on information included in the WTO contract. The WTO judge thus, serves as means to extract information that will help decide if the challenged behaviour is legitimate or not, and will thus help avoid misplaced retaliatory action. In doing that, the

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compensation offered will be linked to the amount of damage inflicted. Whereas it is the author of illegality that will offer compensation, it is the injured party that will draw the list of suspended concessions.

<sup>43</sup> Horn et al. (2011).

<sup>44</sup> We discuss the AB in more detail later. Suffice to state for now that, contrary to the GATT-world, the WTO signals the advent of the AB the second instance 'court' that hears appeals against panels, the first instance 'court' of the WTO.

<sup>45</sup> See the contribution by Jee-Hyeong Park in this volume. Some of the papers have persuasively argued that the frequency of recourse to WTO dispute settlement is no reliable indicator of the performance of panels/AB. Parties might be simply attempting to exploit weaknesses, see Maggi and Staiger (2011), and also Beshkar (2010).

<sup>46</sup> Horn, Maggi, and Staiger (2010).

WTO judge must respect the balance of rights and obligations (reciprocal commitments) struck between the WTO Members. The judge is an agent after all, not a principal.

The end outcome though is binary. Either a violation has been established or not. There is no statutory variation of violations that would entail different remedies. If violation has been established, the road to remedial action opens. If not, this is the end of the road for the complainant.<sup>47</sup>

Private parties have very limited access to WTO litigation. Under Art. X.3 GATT they can access domestic courts on customs-related matters only; under the ‘challenge procedures’, they can litigate before domestic courts on issues coming under the aegis of the Agreement on Government Procurement.<sup>48</sup> It could be that domestic law addresses this issue in a different way. It could be for example, that private parties have standing before domestic courts where they could invoke WTO law. This is not the case, neither in the US, nor in the EU.<sup>49</sup> Litigation is thus largely inter-state. Keeping it to a few players, facilitates, in principle, compromises whereby WTO members fend off disputes between them. Governments are ‘sums of interests’ and they might find it profitable to initiate/stop litigation or avoid compliance (and thus redistribute wealth among their constituents). Private parties might object to similar deals. They cannot challenge them under WTO laws anyway, and many known domestic legal orders are hostile to similar challenges as well.<sup>50</sup>

The process consists of two legs. First an attempt to resolve disputes bilaterally through consultations, followed, if need be, by a request for adjudication of the dispute by a WTO Panel.

### **3.2 Consultations**

#### 3.2.1 Diplomacy First

By ‘consultations’, we understand the bilateral attempt to resolve disputes behind closed doors. It is remnant of the ‘diplomatic’ tradition of resolving disputes, and very much a feature of relational contracts. The GATT was such a contract in its early days when a group of like-minded players negotiated it, and many disputes were indeed resolved in diplomatic manner.<sup>51</sup> In the DSB regime, consultations are a ‘necessary’ first step, in the sense that no panel can be legitimately established in the absence of an attempt to solve disputes bilaterally, as per standing case law.

#### 3.2.2 Bilateral, and yet so Multilateral

Complainant will notify the DSB of its request for consultations, which will thus become available not only to defendant but to the WTO membership at large (Art. 4.4 DSU). Complainant cannot add to the claims identified in the request for consultations at a subsequent stage, as per standard case law. Notifying the DSB is akin to preserving the umbilical cord between bilateral disputes and the multilateral system. It also helps those with less capacity to detect illegal behaviour to become aware

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<sup>47</sup> If violation has been established but the measure has been removed, then no remedial action is necessary. We will return to this point infra. For remedial action to be on the cards though, there is no need to establish violation. Even in case no violation has been committed, remedial action might be due if trading parties affected by an action/omission did not legitimately expect this course of action, see Bagwell et al. (2002).

<sup>48</sup> Mavroidis and Wolfe (2015).

<sup>49</sup> See Jackson (1969), and Hoekman and Mavroidis (2014).

<sup>50</sup> Hoekman and Mavroidis (2014) explain why this is not the case before EU courts. Jackson (1987) explain that this is also the case in US law.

<sup>51</sup> Mavroidis (2015) provides evidence of early GATT cases where blatant violations of the prohibition to impose quantitative restrictions were tolerated following a promise that they would be eliminated within a reasonable period of time.

of trade barriers. There is empirical evidence to support this view.<sup>52</sup> Only 35% of all G2<sup>53</sup> complaints against G2 and 39% against IND are cases where G2 joined in consultations. DEV countries, on the other hand, have a high propensity to join in when the target is the G2 (in 75% of all their complaints against G2, DEV joined in consultations). This observation could provide some ammunition to those who argue that participation is also a function of information, although additional inquiries are necessary to establish whether this is indeed the case. Bargaining power considerations could sustain similar conclusions, and to our knowledge, no one has investigated this issue any further.

### 3.2.3 Diplomacy Matters

The majority of disputes are resolved at the consultations-stage. Approximately 2/3 are ‘resolved’ at this stage, as Busch and Reinhardt (2002) have first shown in a paper praising the merits of settlements at the consultations-stage. Today, out of 491 requests for consultations, 165 panel reports have been issued, while 29 cases are still pending. Almost 40% of requests have been submitted to the next stage, which leaves us with 60% of all disputes ‘settled’ at the consultations stage.<sup>54</sup>

Complainant can refer the matter to a panel if 60 days after the initiation of consultations no solution has been reached. In the real world though, this rarely happens. Horn et al. (2011) calculate the average length of consultations at 164 days. Complainants might have little incentive to go through the laborious process of submitting their dispute to a Panel, and go through the motions of various procedural steps that we describe later. The absence of retroactive remedies at the end of the litigation process, if the need for remedial action has been established, adds to their incentive to consult aiming for a speedy solution rather than follow the ‘normal’ process and submit to a panel on day 61.<sup>55</sup>

### 3.3 Litigation before a Panel

A panel is the first instance WTO ‘court’. It is composed of 3 panelists (judges) who are selected from a roster that comprises over 400 individuals.<sup>56</sup> Only WTO members have the right to propose individuals for inclusion to the roster. No proposal has so far been declined, since inclusion in the roster does not automatically guarantee a place in a panel. In fact, there are no recorded discussions in the DSB regarding the ‘quality’ of individuals proposed for inclusion in the roster.

Following a request for establishment of panel, the WTO Secretariat will propose names from the roster and, if the parties agree to them, a panel will be established. Otherwise it is the Director-General of the WTO that will ‘complete’ the panel upon request.<sup>57</sup> Non-roster panelists have been chosen as well, in fact quite often so. Typically, panelists are current or former government officials stationed (or

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<sup>52</sup> Horn et al. (2011) discuss this issue.

<sup>53</sup> This classification comes from Horn et al. (2011). G2 is the EU, and the US. IND is the remaining OECD members. BRICS are Brazil, Russia, India, China, and South Africa. DEV are all developing countries minus LDCs. LDCs are the poorest developing countries that the UN designates as such.

<sup>54</sup> To refer to them as ‘settled’ is probably quite optimistic. We often lack information regarding settlements at this stage. ‘Mutually agreed solutions’ (MAS), GATT-speak for settlement must be WTO-consistent (3.5), and the DSB should be made aware of them (3.6). Horn and Mavroidis (2007) note that the record of notifications is poor, and their content quite often un-informative. Aggrieved parties can of course, initiate new litigation. For various reasons, this happens rarely. We will return to this question infra. Davey discusses the issue of inadequate notifications (2007).

<sup>55</sup> On the other hand, the unwillingness of panels to recommend retroactive remedies incentivizes parties to avoid offering as much at the consultations stage. Defendants have thus, other things equal, an incentive to procrastinate, whereas complainants to agree at this stage and avoid the laborious panel/AB process.

<sup>56</sup> The possibility to use 5 panelists exists (8.5 DSU), but has not been used so far in the WTO-era.

<sup>57</sup> Horn et al. (2011) report that the DG has appointed at least one Panelist in over 61% of all cases. The DG must consult not with the parties but with the Chairman of the DSB and the relevant Council before appointing (8.7 DSU).

previously stationed) in Geneva.<sup>58</sup> Usually, nationals of a party to a dispute do not serve as panelists, although infrequently this has been the case.<sup>59</sup> Panels enjoy the support of the WTO Secretariat. This is almost necessary, since the majority of panelists are not experts in WTO law by any stretch of imagination. The ‘deference’ towards expertise provided by the Secretariat depends on various factors, and it is hard to ‘measure’ it since the process is confidential (14.1 DSU). There are good reasons to believe though, that it can be, on occasion, quite substantial.<sup>60</sup>

### 3.3.1 Mandate

Parties can raise various claims, even ‘heterogeneous’ claims (e.g. they can attack a measure for violating commitments both under the GATT as well as the GATS) before a panel. The ambit of the panel’s review is circumscribed by the claims submitted to it (6.2 DSU).<sup>61</sup> It cannot ex officio add to the claims.

Panels will accept or reject claims. They act as ‘triers of fact’, and use WTO law as legal benchmark to assess consistency of challenged practices with WTO. It suffices that a panel adopts one of the claims advanced, and, provided that the measure has not been rescinded already, it will recommend corrective action. We will return to this question later.

Panels have unlimited investigating powers and can ask parties any question they deem appropriate (13 DSU). They can further invite experts, although they have so far limited invitations to experts in SPS<sup>62</sup> cases only, where they are routinely facing ‘adversarial’ scientific expertise. The system is thus mixed ‘adversarial/inquisitorial’, since parties circumscribe the ambit of dispute, but panels called to investigate the soundness of claims possess unlimited freedom to inquire into the subject matter of disputes brought before them.

### 3.3.2 Process

Once the panel has been established, it will organize two meetings with parties, where third parties (WTO members that are neither complainants nor defendants) can assist provided that they have expressed their interest to this effect in timely manner (Art. 10 DSU). *Amici curiae* (the ‘civic society’) can send their briefs as well, but panels retain discretion over their eventual use in the proceedings.

The statutory duration of panel process is 180-270 days. De facto, panels take on average 445 days to complete their work.<sup>63</sup>

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<sup>58</sup> Johannesson and Mavroidis (2015) show that over four fifths of all Panelists fall into this category.

<sup>59</sup> Johannesson and Mavroidis (2015) report all similar cases, which are very very few indeed.

<sup>60</sup> Johannesson and Mavroidis (2015) mention the remuneration of Panelists, and the background of the ‘typical’ Panelist as two grounds arguing in favour of deference. It is not a question of incentives only though, but of expertise as well. The report on US-COOL (Article 22.6-US) is a very appropriate illustration. In order to quantify the amount of retaliation, the Arbitrators have had to have recourse to elaborate econometrics, when none of them has any expertise in this area.

<sup>61</sup> A ‘claim’ is the unit of account so to speak in adjudication, and refers to the identification of a subject matter (‘measure’) and the provision of the WTO that it runs counter to. ‘Arguments’ in support of claims are the various rationales explaining why a claim holds.

<sup>62</sup> SPS stands for the Agreement on Sanitary and Phyto-sanitary Measures. This agreement grossly covers policies aimed to address diseases or pests that are transmitted through livestock or foodstuff. Measures must in principle be adopted following a scientific risk assessment, and this is the main reason why experts are routinely invited by panels in order to assess the consistency of challenged policies.

<sup>63</sup> Horn et al. (2011).

### 3.3.3 Outcome

Panels must issue reasoned reports (12.7 DSU). Panel reports reflect in the overwhelming majority of cases a unanimous opinion. There are a dozen or so reports where dissenting opinions have been issued, which have to be anonymous (14.3 DSU).

## **3.4 Litigation before the AB**

The AB is a WTO novelty, and provides the second instance of adjudication of disputes. Unlike panels, AB members serve a term of four years, renewable once for an additional four year-term. A Committee comprising the Director-General of the WTO and Chairs of the most important WTO bodies selects the AB members. All WTO members can propose candidates for selection to the AB. Geographic distribution emerges as the key criterion, and the EU and US are the only two WTO members nationals of which have always enjoyed a seat in the AB. The overwhelming majority of AB members have studied law (only a couple of AB members so far have had some economics background), and recently the majority of appointments are former government officials. They are better remunerated than panelists, since they receive a lump sum on top of ad hoc payments for work done on specific cases, and are assisted by a group of lawyers acting as clerks.<sup>64</sup>

### 3.4.1 The Mandate

The AB hears appeals against panel reports, and has the power to accept, reject, or modify (accept the outcome albeit for different reasons) the original findings. Its review is limited to issues of law, hence the AB findings are somewhat ‘detached’ from facts. Consequently, interpretations of provisions by the AB should, in principle, apply across cases. Although there is nothing like ‘binding precedent’, case law (Mexico-Stainless Steel) has made it clear that panels are expected not to deviate from interpretations reached by the AB, unless of course they can point to ‘distinguishing factors’. As with panels, AB cannot ex officio add to claims submitted by parties to a dispute.

### 3.4.2 The Process

Following a notice of appeal, a ‘division’ of three AB members will hear a case. The formula for selecting the division is unknown. The AB will organize one meeting with the parties, and enjoys investigative powers similar to those of a panel. It issues its report within 91 days on average, the statutory maximum duration of the process being 90 days.<sup>65</sup>

### 3.4.3 Outcome

The AB must issue reasoned reports, where dissenting, anonymous opinions might feature.<sup>66</sup>

## **3.5 Enforcement of Decisions**

Enforcement of WTO obligations has almost monopolized the interest of the law and economics literature.<sup>67</sup> Recall that it is WTO members that can ‘incite’ recalcitrant states to comply with their

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<sup>64</sup> Johannesson and Mavroidis (2015).

<sup>65</sup> Horn et al. (2011) have calculated the average.

<sup>66</sup> Three dissenting opinions have been issued so far in US-Upland Cotton (DS267), in US-Zeroing (DS294), and in EC-Large Civil Aircraft DS316). Separate but concurring opinions have been issued in EC-Asbestos (DS135), and in US-Large Civil Aircraft (DS350, 353).

<sup>67</sup> For a survey, see Horn and Mavroidis (2007), and for a recent contribution on this score, Wu (2015).

obligations through threat/adoption of countermeasures, since the WTO itself cannot impose any sanctions.

### 3.5.1 Compliance Process

For compliance to be an issue at all, the illegal measure must be extant at the moment when the report (panel/AB) has been issued. If the challenged measure has been removed in the meantime, then the panel/AB will issue a ruling to the effect that the illegal measure has been already removed, without recommending anything else. Case law is consistent on this point (AB, US-Certain EC Products, §81). Only if the illegality persists, will the panel/AB issue a ‘recommendation’, and may issue a ‘suggestion’ as well.

Suggestions reflect the panel’s view on what precisely should be done in order to achieve compliance. In principle, thus, they could be seen as very helpful in the quest for compliance as they provide a concrete benchmark to evaluate implementing activities. De facto, they have been issued a handful of times only. It is true that there have not been many requests, since WTO membership has privileged an ethos in favour of ‘non-intrusive’ remedies. Very few requests for suggestions are recorded.<sup>68</sup> Case law has heavily undermined their usefulness by consistently underscoring the nonbinding nature of suggestions. It is difficult to understand which way causality runs. Have members refrained from requesting suggestions because of case law, or is it that WTO panels tried to emulate the prevailing ethos of their principals?

At any rate, consistent case law holds that panels do not have to issue suggestions even when requested to do so (US-Antidumping Duties on OCTG, AB, §189). Suggestions are nonbinding on their addressees. Case law (EC-Bananas III, Article 21.5-Ecuador, Second Recourse, AB, §325) suggests that WTO members, even when they have implemented a nonbinding suggestion, cannot benefit from a presumption that compliance has been achieved.

We thus, de facto, live in a predominantly ‘recommendations’-world. Panels/AB must recommend when facing a persisting illegality, that defendant ‘brings its measure into compliance’ with its obligation. This is the standard content of any recommendation by virtue of Art. 19.1 DSU. Addressees have thus, substantial discretion how to achieve this result. There are some limits of course, since they cannot at any rate continue doing what they had been practicing in the past.

Armed with a favourable outcome, the complainant will request from defendant to bring its measure into compliance. Compliance should be achieved unilaterally, or within a RPT agreed bilaterally or, in case of disagreement, by requesting from an Arbitrator, usually, a present or former AB member, to decide on its length (Art. 21.3 DSU). On 29 occasions so far, an Arbitrator has defined the ‘reasonable period of time’ within which implementation should occur, since the parties to the dispute could not agree to it.

Agreement between the parties that implementation has occurred within the RPT, however defined, will signal the end of the dispute. Disagreement will result in renewed litigation. Complainant will have to request from a ‘compliance panel’, the report of which can be appealed, to decide whether compliance has occurred (Art. 21.5 DSU)<sup>69</sup> and, depending on the response, complainant might have the right to force compliance through countermeasures.

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<sup>68</sup> Palmeter et al. (2016).

<sup>69</sup> A ‘compliance panel’ is what its name indicates. It is the original panel, if possible, that is called to decide this time one issue only: has the defendant taken measures that are adequate for it to be deemed to be in compliance? An affirmative response (by the panel and/or the AB) will signal the end of dispute. A negative response could signal the beginning of a request to impose countermeasures. See Charnovitz (2009), Trebilcock and Howse (2013).

RPT when agreed bilaterally is on average 9.3 months, whereas it extends to 11.7 months when an Arbitrator has decided on its length. The statutory deadline for compliance panels to issue their report is 90 days, and the same applies to AB. In practice, the former take 253 days to issue their report, and the latter, 88.<sup>70</sup>

### 3.5.2 The Last Resort

Facing noncompliance, either because defendant took no corrective action or because action taken was judged inadequate, complainant can retaliate by imposing countermeasures, ‘suspension of concessions’ in WTO-parlance. To this effect, it will present a list of products the level of tariffs of which it will purport to raise vis-à-vis the defendant only. In case defendant agrees with the list presented, complainant can start imposing countermeasures.

If there is no agreement regarding the appropriateness of the level of proposed countermeasures, complainant can request from an Arbitrator, the original panel if possible, to decide on their level (Art. 22.6 DSU). Countermeasures can remain in place until compliance has been achieved. In case there is disagreement as to whether compliance has been achieved, a new panel should be instituted to this effect, the report of which is appealable.<sup>71</sup>

Law addresses explicitly the level of countermeasures. The damage inflicted should be equal to the damage suffered (Art. 22.4 DSU). Thus, by law, countermeasures should, in principle, guarantee that reciprocal commitments will not be disturbed as a result of the commission of an illegal act.<sup>72</sup>

### 3.5.3 It’s a Long Way to Tipperary (or is it?)

The process might strike lengthy (approximately 1192 days on average plus the time to request establishment of Panel before the DSB, send notice of appeal etc.), but of course it all depends on what the benchmark is. It roughly corresponds for example, to the length of process before the two EU courts. The length is largely function of the resolve of WTO members to ensure during the negotiating stage the advent of one key provision: Art. 23.2 DSU, that is, the provision that guarantees all decisions regarding illegality of challenged measures should be exclusively taken by WTO judges, and not by affected parties.<sup>73</sup>

## 4. Practice

### 4.1 Process

The WTO dispute settlement system is often described as the busiest state to state-court there is. The numbers are impressive indeed. Hudec (1993) reports 250 disputes during the GATT-era. On November 9, 2015 the 500<sup>th</sup> dispute was submitted to the WTO. Were we to control for the time span of the two institutions (47 years for the GATT, twenty years for the WTO), then the number of WTO disputes becomes even more impressive. Of course there are counter-balancing factors as well. There

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<sup>70</sup> Horn et al. (2011).

<sup>71</sup> The AB established this much in US-Suspended Concession, stating that the new Panel could be a ‘compliance Panel’, e.g. a Panel with ‘limited mandate’ as discussed supra.

<sup>72</sup> Or even a legal act that has given rise to a lawful right to compensate. This is what ‘non violation’ complaints amount to the function of which has been best explained in Bagwell and Staiger (2002).

<sup>73</sup> Statutory deadlines to a large extent replicate those of US Section 301, removing thus the argument from the US delegates that the trading system does not guarantee speedy resolution of disputes.



are more members, and more agreements nowadays.<sup>74</sup> The distribution of disputes across WTO Members looks like this:<sup>75</sup>

	Complainant	Respondent	BIC	DEV	G2	IND
BIC	11.4%	12.3	2.0	9.8	74.5	3.7
DEV	22.2	18.2	5.0	36.4	47.5	11.1
G2	40.0	48.5	20.6	15.1	35.8	28.5
IND	26.2	21.0	9.4	11.1	58.1	21.4
LDC	0.2	0	0	0	0	0

The GATT is the agreement that dominates the subject matter of litigation. Claims under the GATT represent 94.2% of all claims, under GATS, 2.3%, and under TRIPs, 3.5%. G2 represent 85% of all claims under TRIPs, 50% for GATS, and 37% for GATT; BIC, 9% for TRIPs, and 9% for GATT; IND, 6% for TRIPs, 17% for GATS, 32% for GATT; DEV, 33% for GATS, 21% for GATT; LDCs, 1% for GATT.<sup>76</sup>

#### 4.2 Calculating the Amount of Countermeasures

Recall that the law pre-empts Arbitrator's discretion as to the level of permissible retaliation, since it must be substantially equivalent to the damage inflicted. Note nonetheless, that in *Canada-Aircraft* (Article 22.6-Canada) the panel added a 20% mark up on the level of countermeasures calculated only because Canada had stated that it would maintain the contested subsidy programme irrespective of the outcome of the dispute (§3.49). This is a case of 'punitive damages', a one-off case, since the conclusion reached here has never been repeated in any other report. The soundness of the approach was not contested, but no other Arbitrator ever has had recourse to punitive damages.

<sup>74</sup> Horn et al. (2005). Some authors compare the WTO to say the ICJ (International Court of Justice), which adjudicates less than two disputes/year. It is inappropriate comparison though, since the ICJ, unlike the WTO cannot adjudicate a dispute without the consent of defendant. Comparisons with investment fora are equally unwarranted. It is private parties that complain there, they do not need the governmental 'green light' to litigate. The WTO would have probably been inundated with disputes, had private parties been acknowledged the right to sue before it.

<sup>75</sup> The Table is composed from information in Horn et al. (2011). G2 covers EU, and US; BIC, Brazil, India, China; DEV, developing countries; IND, OECD members; and LDCs the least developed countries. Various studies have tried to explain what explains participation. Horn et al. (2005) argue that participation represents more or less share in world trade. Analysts have focused on the cost of litigation, like Bown (2005), and the twin issue of embedded legal expertise, like Horn et al. (2011). Nordström and Shaffer (2008) argue in favour of a 'small claims tribunal', a low cost mechanism that would incite developing countries to litigate more, since their claims do not typically involve payment of large sums, and might be deterred to submit to the usual procedure because of the cost of litigation.

<sup>76</sup> Horn et al. (2011). It is not the purpose of this paper to advance explanations why most of the activity is in GATT. A few words seem warranted though. If there is one area where all commentators agree about GATS is that it did not generate liberalization, it simply 'crystallized' into law the pre-existing regime. Under the circumstances, the number of disputes observed should come as no surprise. The TRIPs story is a bit different, since the EU and US pushed a lot for inclusion of this agreement in WTO. The low number of disputes might come as surprise. One should not forget though, that developing countries originally benefitted from transitional periods. Furthermore, TRIPs is about enacting laws that observe 'minimum standards', it is in PTAs that one expects to see far-fetched disciplines. One should also be mindful of the fact that many complaints would address omissions to enforce, and the burden of proof associated with complaints against omissions should not be under-estimated. And then, one should not neglect that the provisions in TRIPs of interest to companies (like 'compulsory licensing') are full of holes and loopholes. Note also that this is an area with a high number of settlements. Out of 34 requests of consultations, only 10 cases were submitted to a Panel, of which only 3 were appealed. Discussions in the TRIPs committee, and the transparency regarding challenged measures provided therein are also factors contributing to settlements. Finally, WTO remedies are not attractive, as private companies might be in position to win more by litigating before domestic courts. We will return to this point *infra*.

The law does not address the method that Arbitrator must use in order to quantify damages. Case law has moved in to fill the gap. Actually, it has not just filled gaps when doing so. It has probably undone the basic understanding among principals, since arguably the manner in which damages have been calculated falls short of ensuring that reciprocal commitments are not disturbed as the result of the commission of an illegality.

First, case law has consistently established that retaliation shall be calculated from the end of the RPT.<sup>77</sup> We live thus, in a world of de facto prospective remedies.<sup>78</sup> Since there is no room for injunction relief in the WTO, the absence of retroactive remedies entails that WTO members violating the agreement will enjoy a few years of exit from the contract, which will remain unpunished. We will return to this issue later.

Second, damages do not cover ‘indirect benefits’. US lost its claim against the EU that it should be compensated for lost income resulting from reduced exports of fertilizers to Mexico, as a result of the impossibility of Mexico to export bananas to the EU (EC-Bananas III (Ecuador) (Article 22.6-EC), §§6.12-14).

Third, what matters is only value added, and nothing else. Mexico could not be compensated using the total value of exported bananas to the EU as benchmark, but only for Mexican added value to the production of bananas. Mexico had to reduce the value of imported fertilizers since, in the presence of the EU ‘ban’ on bananas it would not need to import fertilizers anymore (EC-Bananas III (Ecuador) (Article 22.6-EC) §6.18).

Fourth, legal costs are not recoverable (US–1916 Act (EC) (Article 22.6–US), §5.76).

Fifth, while the agreement calls for suspension of concession or ‘other obligations’, case law seems to have closed the door to the latter possibility. This question arose during the proceedings in US–AD Act 1916 (EC). Having secured a ruling to the effect that the US AD Act 1916 was WTO-inconsistent, and faced with non-compliance by the US during the RPT, the EU submitted to the US its proposal to adopt ‘mirror legislation’, and be allowed to impose punitive damages against dumpers. In the absence of agreement with the US, the EU tabled the same request before the Arbitrators who were asked to pronounce on whether the proposed mirror legislation satisfied the requirements of Art. 22.4 DSU. The Arbitrator responded in the negative. In their view, the EU should be permitted to suspend concessions equivalent to the amount of nullification and impairment suffered each time the US AD Act 1916 was being applied against EU economic operators. It was prohibited, however, from adopting mirror legislation since a similar measure would not be WTO-consistent because the equivalence between damage suffered and suspension of concessions could not be ex ante guaranteed and thus, Art. 22.4 DSU would have been violated as a result (US–AD Act 1916 (Article 22.6–US), §§ 7.3–9).

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<sup>77</sup> EC–Hormones (US) (Article 22.6–EC), § 38; EC–Bananas III (Ecuador) (Article 22.6–EC); Brazil–Aircraft (Article 22.6–Brazil). The best proof is the presence of consistent case law to the effect that no recommendation is due when an illegality has been brought into compliance after the process had been initiated. In this case, Panels will routinely issue a ruling to the effect that the illegality has been complied with. It follows that, in the absence of recommendation, no claim can be raised regarding damages suffered between the occurrence of illegality and the date when compliance occurred.

<sup>78</sup> In the WTO-era, only one Panel (Australia–Automotive Leather II) held that remedies could be applied retroactively. It did so expressing an ‘inconsequential’ view (‘obiter dictum’), since it did not have to decide on the level of countermeasures. A nonjurist might be tempted to argue that there is nothing prospective in counting retaliation from the end of RPT. Two parties might legitimately disagree as to the interpretation of a provision, and illegality is established only at the moment when a judge has pronounced to this effect. Consistent practice in international law suggests the opposite to be true. Judgments have ‘declaratory’- and not ‘constituent’ effect. They simply declare that an illegality has been committed and it is facts alone that decide at what point in time this has been the case. If we were to take the opposite view, not only would we be arguing against a basic tenet of international law but also of common sense. Do we need to await the judgment of a judge to decide that Home violated its obligations when imposing antidumping duties without conducting an investigation?

Finally, case law has made recourse to cross-retaliation relatively onerous. Law states that concessions should be suspended within the same sector, and, ‘if that party considers that it is not practicable or effective, it can move to another sector and eventually to another agreement’ (22 DSU). The latter option is termed ‘cross retaliation’, and has some obvious advantages for WTO members with smaller bargaining power. By violating TRIPs, for example, the value of brand names is reduced, and as most of the brand names originate in OECD countries, the proponents of introduction of TRIPs in the WTO regime, this is a risk they could do without.

An anecdote offers appropriate illustration of the attitude of OECD countries towards cross-retaliation. Robert Zoellick (ex-USTR), in a visit to Brazil, was confronted with a question regarding the possible US reaction in case Brazil were to impose lawful suspension of concessions under TRIPs (that is, cross-retaliate). Zoellick quickly pointed out that Brazil might be facing countermeasures itself in that case. The US could be removing some GSP benefits:

There’s always a danger in trade relations—these things start to slip out of control. You know, keep in mind, Brazil sells about two and a half million dollars under a special preference program to the United States, under the GSP. We have been working with Brazil because of the problems of intellectual property violations here, which could lead to their removal. It did in the case of Ukraine. So, I think it is dangerous for people to go down these paths because one retaliates, and all of the sudden you might find out that something else happens. We have felt—in the case of intellectual property rights—that Brazil is trying. We’ve decided to give time to work, to try. But, one decides to retaliate, well, who knows, maybe others will too. (Transcript of Joint Press Availability, Deputy Secretary of State, Robert B. Zoellick, and Brazilian Finance Minister Antonio Palocci, Ministry of Finance, Brasilia, Brazil, October 6, 2005).

There is a dynamic risk as well. Counterfeiting requires the implementation of production capacities, which will be hard to crack down when there is no more valid reason for imposing countermeasures. And finally, there is a quantification issue as well.

In EC-Bananas III (Ecuador) (Article 22.6-EC), the panel faced a request by Ecuador to cross-retaliate up to \$261million (the level of total damage suffered from the EU policy on bananas) in the area of TRIPs. The panel held that it had the right to review whether Ecuador had objectively reviewed the facts of the case when reaching this figure. It then revised Ecuador’s calculation, and authorized suspension of up to \$60million in the realm of goods, and \$201million in the realm of TRIPs.<sup>79</sup>

Finally, we mentioned that compensation is the other interim measure until compliance occurs. It can take the form of cash compensation and did so twice: in US-Section 110(5) Copyright Act, and in the US-Upland Cotton dispute. In the former case,<sup>80</sup> the US agreed to pay a yearly instalment to the EU for violating TRIPs. In the latter case, the US paid Brazil an amount for violating the SCM Agreement.<sup>81</sup> It is a voluntary measure though, and cannot be enforced against recalcitrant WTO members.

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<sup>79</sup> Anderson (2002) states that ‘practicability’ is a key element here, although he would prefer cross-retaliation any time it is ‘ineffective’ to do so in the same sector. One reason explaining the decision of Arbitrators in EC-Bananas III, is probably that they observed that Ecuador had already \$60million trade in goods with the EU, and it was hence ‘practicable’ to retaliate in this area. They thus, relegated ‘effectiveness’ to a second order concern. Through their attitude, they implied that Art. 22.3 DSU is not ‘self judging’, a rather deplorable outcome, since Ecuador (and others) would eventually have to pay for errors committed by Panels regarding effectiveness of their retaliation.

<sup>80</sup> Grossman and Mavroidis (2003) discuss this report. US paid slightly over \$1 million per year for the first three years, and as of then it has been regularly reporting its efforts to implement the report.

<sup>81</sup> WTO Doc. WT/DS267/43-46.

### **4.3 Property, or Liability Rules?**

Pascal Lamy, when he was EU Commissioner for Trade (before he was appointed DG of the WTO), was quoted saying that, as long as a WTO Member is prepared to ‘pay’ (that is, be subjected to suspension of concessions), it can lawfully continue to violate the WTO (European Union Press and Communications Service, No 3036, May 23, 2000). Is this the correct view?

The law (Art. 22.1 DSU) states that:

... neither compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation to bring a measure into conformity with the covered agreements.

This has ‘property rules’ written all over it.<sup>82</sup> And yet, assuming concessions have been suspended, they can stay in place as long as the illegality persists. There is no statutory deadline within which culprits must start respecting the contract all over again. De facto thus, by accepting to ‘pay’, the offender can continue to violate the contract ad infinitum. It can thus, ‘buy’ its way out of the contract. This understanding is probably not in line with the ‘spirit’ of the DSU, but there is nothing in the text that makes it legally impossible.

For the reasons explained later, it is doubtful whether the WTO regime can be described as ‘efficient breach of contract’. It is, we will argue, unclear at best (doubtful at the very least) that WTO members can all equally profit from ‘paying’ their way out. ‘Liability rules’ nonetheless are not synonymous to ‘efficient breach of contract’, and this is what de facto the WTO regime can amount to.<sup>83</sup>

### **4.4 Recap**

The discussion so far shows that in practice the balance of rights and obligations is not restored following a decision by Arbitrators to retaliate. The time between the commission of illegality and the time when retaliation can be imposed is the reason why. In the name of securing impartial decisions, WTO members were thus prepared to accept to lose some of their entitlements. This does not necessarily mean that reciprocity is not observed. It is clear that the *original* balance of rights and obligations will not be restored. It could be though, that all complainants lose symmetrically. Then, reciprocity would be reinstated. It is of course, a very challenging exercise that is required in order to demonstrate that, the departure from the original balance of rights and obligations notwithstanding, reciprocity is still observed. We will return to this discussion in Section 5.

The paradox in the WTO dispute settlement system is that it might be more favourable for Home to look for an adjudicated as opposed to a negotiated solution when it is facing a shock. Assume Home citizens are worried about the effects consumption of ‘hormones treated beef’ might have on their health, and there is no way it can justify its measures under the WTO. Home could request negotiations under Art. XXVIII GATT. It would be requesting an increase on its tariff duty for ‘hormones treated beef’, and would be willing to pay compensation by reducing its tariff protection in other areas. Two points are of importance here. First, Home will not, in principle, be in position to profit from ‘prospective’ remedies, since it will not be in position to raise the level of duty until the moment when compensation has been paid. And even if no compensation has been agreed and it still decides to raise its duties, it will be facing immediate unilateral retaliation. Second, Home will have to pay the political price of exposing some of its lobbies to increased competition from abroad. If Home opts for ‘cheap exit’ though, and imposes a quantitative restriction on this commodity, it will have five years before it will be asked to comply. Moreover, it will be in position to ‘buy its way out of the

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<sup>82</sup> Jackson (2004).

<sup>83</sup> Schwartz and Sykes (2002).

contract', if it agrees to pay compensation five years down the road. And it will be Foreign this time that will be deciding the areas where it will retaliate.

## 5. Mind over Matter

In what follows I want to establish that WTO members continue to resolve their disputes in the WTO, the presence of retroactive remedies notwithstanding. The basic reason why in my view they behave in this way is that they value compulsory third party adjudication enough to be prepared to accept some losses in trade income. Furthermore, losses are not blatantly asymmetric.

### 5.1 No Forum Diversion

For the purposes of our discussion, what matters is of course, litigation behaviour by WTO members only. Private parties' litigation behaviour is of no concern, since private parties do not have to respect 23.2 DSU, the obligation on WTO members to submit their disputes exclusively to the WTO forum. We do not care about behaviour of private parties when litigating nonWTO disputes before investment fora and invoke WTO law to support their claims either. There is ample evidence that WTO law is discussed in various investment tribunals, where private agents submit their investment claims against states. It is there that they routinely invoke WTO law.<sup>84</sup> Private agents nonetheless, do not have to observe Art. 23.2 DSU. Our inquiry here is exhausted in instances where WTO members have litigated disputes coming under the ambit of the WTO. The question we ask is whether, when doing that, they have litigated exclusively before the WTO or not.

We have stated that the WTO has already entertained more than 500 disputes in its twenty-year life. The number of disputes is not equally distributed in the two WTO decades. 324 disputes were submitted the first ten years (that is almost 66% of all disputes submitted so far), whereas 177 only ever since.<sup>85</sup> There are various reasons, ranging from the backlog of disputes to the will to 'test' the new regime that probably explain the surge of disputes in the first ten years. Mavroidis and Sapir (2015) submit that the rise in the number of preferential trade agreements (PTAs) could be one additional reason why the number of disputes has dropped, since PTA partners tend to litigate less between them, and very often not at all. The absence of forum diversion, a point to which we will return later, suggests that the current WTO regime continues to enjoy the confidence of the trading nations. Although the number of disputes has been decreasing, the WTO continues to be a very popular state-to-state court by any reasonable benchmark.<sup>86</sup>

#### 5.1.1 Are intra-PTA Disputes an Issue?

Disputes that arise under any PTA concern PTA- and not WTO law. So formally, there can never be forum diversion when a trade dispute is submitted to a PTA forum. But anyway, no matter what the criterion for classifying disputes is, PTAs do not attract much litigation.

Obligations included in PTAs can be distinguished between 'WTO+' and 'WTOx' depending on whether they concern an issue that comes under the WTO mandate or not.<sup>87</sup> The latter term aims to capture trade areas that are not covered by the current WTO mandate. Arguably, litigating similar

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<sup>84</sup> Chevry (2015).

<sup>85</sup> Horn et al. (2011) include statistics regarding the identity of parties, the frequency of appearance, the agreements invoked, the identity of panelists, etc.

<sup>86</sup> Dividing the life cycle of the WTO into four 5 year periods since 1995, Mavroidis and Sapir (2015) report that 187 disputes were lodged the first five years, 137 then, 78, and 84 in the final five years (up to December 2014). Fifteen more disputes have been lodged since than until now (January 2016).

<sup>87</sup> Horn, Mavroidis, and Sapir (2010).

disputes before a nonWTO forum would not amount to a violation of the obligation to submit disputes before the WTO. Consequently, we should be limiting our inquiry into WTO+ obligations: an appropriate illustration would be when for example Home and Foreign, WTO Members, impose say a 10% tariff on widgets, and agree to impose a 1% tariff when trading widgets between them. The classification between WTO+ and WTOx nonetheless, can be tricky, and we propose to see how dispute adjudication in PTA fora in general looks like in order to respond to the question whether forum diversion has occurred.

Before we do that however, there is one final question we need to ask. Are there any cases where WTO members have adjudicated trade disputes outside the WTO and outside a PTA-forum? Horn et al. (2005) mention one instance where two WTO members resolved a dispute through bilateral consultations without having had recourse to Art. 4 DSU first. They did not submit to a different forum though. There is one more known case that concerns dispute about WTO law, where the two WTO members did not have recourse to the DSU procedures. A series of bananas exporting countries requested from the WTO DG to appoint arbitrators to decide on their dispute with the EU, noting that they did not want the process to be considered ‘mediation’ under Art. 5 DSU.<sup>88</sup> In this case nonetheless, the ‘link’ to the WTO remained strong. With this in mind we now turn to the PTA-record.

### 5.1.2 Adjudication Record in PTAs

There are various studies reviewing dispute adjudication at the PTA level and all point to the same result: no or little forum diversion has occurred. According to Chase et al. (2013), dispute settlement mechanisms in PTAs fall in three categories: political/diplomatic; quasi-judicial; and judicial. Political or diplomatic mechanisms are those that have no dispute settlement provisions at all, that provide exclusively for negotiated settlement among the parties or that provide for referral of a dispute to a third-party adjudicator but with the PTA members having a right to veto such referral. By contrast, both quasi-judicial and judicial systems involve decisions by an adjudicating body, but only the latter implies the existence of a permanent adjudicating body such as the WTO’s DSB. Two-thirds of the PTAs notified to the WTO until 2012 belonged to the quasi-judicial category. Koremenos (2007) reports similar results. These studies already establish that only a small minority of PTAs has full-fledged adjudication regimes. By construction thus of dispute settlement procedures under PTAs, forum diversion cannot be substantive.

Li and Qiu (2014) review litigation practice for a sample of over 100 PTAs. They picked randomly their sample without paying attention to the attributes of the PTA litigation regime, e.g. whether it is judicial, quasi-judicial, or political/diplomatic. In fact, they do not even classify their sampled PTAs in this way. Their basic conclusion is that only a handful of disputes have been raised before PTA-fora when participants are also WTO members.

Mavroidis and Sapir (2015) examine all PTAs signed by EU and US since 1992. We have established supra that the EU and the US are the two very active litigating parties in the WTO, the most active indeed. Their behaviour thus, is of utmost interest to this study. All but one of the PTAs they have signed contain a quasi-judicial dispute settlement mechanism. The outlier is the EU-Norway PTA signed on July 1, 1973, which contains no dispute settlement regime at all. Norway, though, can access the EFTA (European Free Trade Association) Court, which is a ‘binding’ regime that handles, inter alia, disputes between EEA (European Economic Area) members, which include both Norway and the EU. Their data supports the view that the EU and the US litigate, in general, less with their PTA partners, and when they do so, they do not divert their litigation to a nonWTO forum. EU for example, has litigated only on a few instances with Norway (whereas, in the WTO-era, it had litigated 22 times with all its PTA partners before it had signed a PTA with them). US has litigated 35 times

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<sup>88</sup> WTO Doc. WT/L/616 of August 1, 2005. The DG appointed two AB members and the former Canadian ambassador to arbitrate this dispute.

with its NAFTA partners and once with Korea. Only 9/35 cases concern new disputes though, since in the remaining 26 cases the subject matter of the WTO dispute had been brought to the negotiating table of NAFTA but no solution could be reached. And even this number (9) is further reduced since some of these cases concern issues where there is no corresponding provision in the WTO contract, and/or areas where private parties have standing.

Under the circumstances it seems fair to conclude that we have not been experiencing forum-diversion. The rise of PTAs coincides with (and probably causes) a reduction of intra-PTA disputes. The accounts by negotiators cited in Boskin (2014) support the view that many of the disputes that might arise will be resolved in amicable manner, without recourse to formal channels. PTAs (or at the very least, some of them) are, in essence, ‘relational’ contracts.

The prediction of Mavroidis and Sapir (2015) for TTIP is that, if past EU and US behaviour serves as benchmark, we should be expecting a reduction in the number of disputes before the transatlantic partners both before the WTO, as well as before the PTA forum. In similar vein, Michael Wilson, key Canadian negotiator of NAFTA and CUSFTA, is quoted stating that one reason explaining recourse to integration of North American market was the desire to reduce trade disputes.<sup>89</sup>

## 5.2 Prospective Remedies: Reciprocity?

The credibility of commitments entered depends of course on the enforcement of agreed obligations, otherwise why commit in the first place? Assuming an agreement between the parties that compliance<sup>90</sup> has been achieved, there is no point in inquiring any further into the question whether reciprocity has been served. We can safely assume that this has been the case. Arthur Dunkel, put it very eloquently, when stating:

Reciprocity cannot be determined exactly, it can only be agreed upon.<sup>91</sup>

In the absence of agreement though, panels are entrusted with the task to ensure that authors of illegalities will not be better off following the commission of an illegality. Authors of illegal acts consistently pay back less than the damage they have inflicted, since in practice, remedies are prospective.<sup>92</sup> The question whether reciprocity can still be respected is a different issue. Before we explore further the question whether prospective remedies serve reciprocity, we need to say a few words about compliance in general.

### 5.2.1 How Much do We Know about Compliance?

The argument is routinely made that the current system works well since it has served its prime objective, that is, to achieve compliance with the rulings issued. Routinely authors refer to WTO dispute settlement as the jewel in the WTO crown, and an enviable regime that should be emulated by all. It is true that we do not hear of trade wars anymore. Is it also true that we do not hear of wars because of high rates of compliance with adverse rulings? If yes, then what is needed is prospective remedies and compulsory third party adjudication. Why then other regimes, like the investment

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<sup>89</sup> Quoted in Boskin (2014) at p. 9.

<sup>90</sup> Inquiring into the motives for non-compliance is not within the ambit of this paper. Illustratively we state that the incentives might be lacking to always respect what has been agreed, and/or sometimes there might be legitimate disagreements as to what exactly has been committed (what does for example, ‘applied so as to afford protection’ mean when it comes to understanding the ambit of the obligation to not discriminate mean.

<sup>91</sup> GATT Press Release 1312, March 5, 1982.

<sup>92</sup> The question whether the payment made should be linked to the profit made by breaching the contract did not even enter the mindset of the framers of the DSU. It is true of course, that benefits from breaching the contract could be of ‘political’ nature. It could help for example, the ruling party from winning support in a ‘swing’ state and thus win re-election.

regime, or the ICJ insist on retroactive remedies? Is the WTO record so good, or is it an impressionistic account that we often encounter in literature?

Let us start by stating that it is difficult to establish the compliance-record at the WTO level. Compliance can occur for many reasons, such as political economy ('use GATT as an excuse'), side payments (promise to vote for the complying party in another forum), reputation costs (for those who care), credibility of the threat in case of non-compliance etc. Many of them are totally un-interesting for our discussion. The issue is whether the WTO system itself induces compliance and not whether for reasons un-related to it compliance has occurred. If compliance occurs for reasons exogenous to the WTO contract, then one can hardly attribute compliance to the efficiency of the WTO regime.

Enter another complication. Very often the rationale for complying is a question of private information. Only the defendant itself might know what deal has been sealed behind closed doors. The incentive of the defendant should be to act opportunistically and not reveal the truth. Does not the defendant look nicer in the eyes of the WTO membership when publicly stating 'it is my duty to comply', than when it states 'I could not afford the political cost of taming my domestic monopolist, thank WTO procedures for allowing me to do so', or 'it is my in my public interest to accept that one producer loses money if this is necessary for me to be member of the UN Security Council'? This is classic prisoner's dilemma. Because of private information and the incentive to behave opportunistically, a comprehensive study regarding compliance in the WTO is a quixotic test. WTO Members have often little incentive to disclose information regarding details of negotiated settlements, and if they do, then they would rather substitute WTO loyalism for opportunistic behaviour.<sup>93</sup>

The compliance record looks good, if we make some assumptions. If we discard the rationale for compliance; if we assume that cases that have not been re-introduced should be accepted as cases where compliance has occurred; if we assume that panel/AB outcomes are relevant only for their addressees, in the sense that condemning zeroing in a dispute between the US and the EU does not mean anything for the same dispute between say Japan and Korea. One might argue though, that with all the 'ifs and buts' mentioned so far, we have probably thrown away the baby along with the bathwater.

Is it so though? If the system did not promote compliance, if it did not work to their satisfaction that is, why use it in the first place? If 'compensation' for complainants when addressing an illegality is suboptimal, then they must be assured that they will profit from similar suboptimal payments when they are defending their measures.<sup>94</sup> Reciprocity must of course, be somehow part of the compliance record. It is simply untenable to keep faith in a regime that consistently favours a specific subset of its membership. The question thus, we need to ask hence is what kind of reciprocity does the WTO regime serve?

### 5.2.2 Specific- and Diffuse Reciprocity

So what kind of reciprocity does the WTO promote through its current system for calculating damages? Keohane's (1986) distinction between 'specific-' and 'diffuse reciprocity' fits nicely for the purposes of this discussion. 'Specific reciprocity' would correspond to a situation where deviations from obligations assumed would be punished so as to ensure that the violating party would pay the damage that bridges the gap between the current situation (where violation has occurred) and a counterfactual where no violation at all had occurred. 'Diffuse reciprocity' is a reduction from this benchmark. The amount of reduction is not specified. Reduction is warranted since there is 'trust' between players that deviation will be addressed anyway, and today's culprit will be tomorrow's

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<sup>93</sup> Collins-Williams and Wolfe (2010) make a persuasive case why incentives drive the quantity and quality of notifications.

<sup>94</sup> An interesting question to explore would be whether the system of prospective remedies promotes the commission of illegalities, although the counterfactual would be very difficult to establish.



generous player who will accept similar deviation from other players, safe in the knowledge that they will be addressed in time as well. If violations are addressed imperfectly when Home has committed an illegality, they will be addressed imperfectly when Foreign violates its obligations as well. Thus, in principle, reciprocity will be observed in some rough manner even in the latter scenario, since all could profit from ‘cheap’ exit at one point in time. Punishment in other words in the diffuse reciprocity scenario, so the argument goes, would be imperfect for all WTO members.

Remedial action should, in principle, cover the distance between the committed illegality and a world where no illegality had been committed. The benchmark (counterfactual) to quantify the damage done should be a world where no illegality has been committed. That much is clear in standard legal theory. It is against this benchmark that the damage inflicted should be calculated (and the amount of ‘compensation’ should be awarded) in order to ensure absolute compliance with the agreement.

Since damage is inflicted from the moment an illegality has been committed, it is from the moment of breach that the extent of remedial action should be calculated. Damage, as we have explained above, in legal theory, does not exist from the moment a court so says, but from the moment an illegality has been committed. Challenged practices do not live in the ‘twilight zone’ of doubt and become illegal only at the moment when a judge had so stated. Court decisions *declare* that an illegality has been committed, they do not *establish* it for the first time. In this vein, for reciprocity to be served, remedial action must wipe out all consequences of illegality from the moment it occurred.

Retroactive remedies would definitely get us closer to reciprocity, since they would ‘travel the distance’ between the world where an illegality has been committed, and the world where the contract has been observed by all. Keep in mind though, that, realistically, even a system of retroactive remedies would not necessarily de facto serve reciprocity, as it might turn out to be ‘useless’ weapon in the hands of ‘smaller’ players. We will return to this point in the next subsection. Retroactive remedies serve reciprocity when they are implemented. Rational policies nonetheless, might argue against implementation.

Do prospective remedies serve diffuse reciprocity?<sup>95</sup> Leaving bargaining power-considerations aside for a moment, there is one crucial difference between prospective and retroactive remedies when it comes to deciding whether they serve equally well (or bad) reciprocity. The date of detection of an illegality is immaterial in the world of retroactive remedies. No matter when one discovers the commission of an illegal act (leaving aside extreme examples of course, against which an ‘estoppel’/‘acquiescence’ defence can be mounted), it will be anyway compensated as of the date when the illegality was committed. Conversely, in the world of prospective remedies the moment of detection is quite important. The closer it is to the commission of the illegality, the likelier it is that reciprocity will be served.

### 5.2.3 Specific-, Diffuse Reciprocity and the WTO

The question thus becomes whether WTO members have symmetric powers to detect illegalities. We will assume that they have symmetric willingness to punish violators. While bargaining power might remove the incentive from ‘smaller’ players to prosecute ‘big fish’, lack of trade impact will remove the incentive of ‘big fish’ to prosecute ‘smaller’ players. We will also assume that every WTO member violates the contract with the same frequency. This is a generous assumption, of course. It could be that for domestic law/political economy reasons, some cannot and do not deviate from WTO obligations with the same ease as others.

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<sup>95</sup> Beshkar (2010) has argued that less than proportional remedies are the most efficient remedies in a regime like the WTO where governments have private information about lobbies’ pressure to comply or not with adverse judgments. Practice confirms his theoretical insight.

WTO members do not share the same capacity to detect deviations. The most powerful between them can rely on a highly diversified export portfolio and consequential presence of trade diplomacy around the globe. Weaker nations cannot rely for which information is costly, cannot rely on the WTO to supply it (the TPRM, Trade Policy Review Mechanism, or on the notification system). The former offers scattered information on periodic basis, whereas the record of notifications of national measures is good only when notifications are incentive compatible.<sup>96</sup> In the absence of centralized enforcement,<sup>97</sup> those with the more sophisticated administrations will be in better position to detect deviations and act faster, if they deem it appropriate, reducing thus the period of impunity for deviators.

The WTO cannot of course, become the ‘great equalizing factor’, and undo asymmetries across its various members. It cannot pretend that the system in place guarantees absolute respect of reciprocal commitments either. How much of a problem is it though? As we have already explained, the WTO must be notified of all requests for consultations. Empirical evidence supports the conclusion that those with less bargaining power usually join in consultations. In light of this, asymmetric detection powers do not seem to be much of an issue. Those that discover illegalities later will jump on the bandwagon of consultations roughly at the same time with the original complainant. It is true that defendants can always refuse similar requests, but then, armed with information concerning illegalities, they can initiate their own dispute. Once again, the regime does not equalize absolutely identical losses, but roughly comparable. This is what diffuse reciprocity aims to capture.

The proposals submitted by developing countries regarding remedies during the Doha round, suggest that they are unhappy with the current state of affairs. Some of them have re-iterated their desire to see retroactive remedies introduced into the WTO system.<sup>98</sup> They have repeatedly taken the view that they do not benefit equally from the current regime. They seem to imply that bigger players can certainly exercise ‘behind the scenes’ diplomacy in order to advance their preferences. ‘Big’ guys have anyway more ‘persuasive’ power, in that they have more weapons to use when they decide to retaliate.<sup>99</sup> This however, would be the case irrespective whether the WTO had espoused retroactive remedies or not.<sup>100</sup> Developing countries, their disappointment with the current regime notwithstanding, have not stopped using the system, and have not used PTA dispute adjudication either. They ‘bite the bullet’ and continue to be active, by reasonable benchmarks such as those offered in Horn et al. (2005), participants in the WTO dispute settlement system.

#### 5.2.4 Bargaining Power

How much of the analysis above is put into question by the asymmetric endowments of WTO members? Empirical papers, like Bown (2002), and Bown and Reynolds (2015), have shown that implementation is facilitated when the terms of trade effect is small. But there is more. Annex 2 reflects all cases where recourse to retaliation has been made so far. With one exception, they are cases between members of comparable bargaining power. The odd case is US-Upland Cotton, where the ‘big’ trader agreed to ‘pay’ the ‘smaller’ trader when faced with a threat for countermeasures.

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<sup>96</sup> While most commentators celebrate the record before the TBT and the SPS Committee, they deplore the record before the ILC and the SCM Committees, see Collins-William and Wolfe (2010).

<sup>97</sup> Hoekman and Mavroidis (2000).

<sup>98</sup> WTO Doc. TN/DS/26 of January 30, 2015.

<sup>99</sup> The analysis by Bernheim and Winston (1990) is certainly relevant here.

<sup>100</sup> Bagwell (2008), and Bagwell et al. (2011) have advanced ‘imaginative’ proposals to address asymmetric bargaining power (tradable remedies), which nonetheless have not been espoused by the WTO Membership. Some developing countries have advanced proposals to adopt remedies de-linked from a prior damages quantification, such as, the impossibility to bring a dispute unless the complainant has first implemented all prior rulings against it. At the moment of writing, it is almost utopian to suggest that similar proposals have any chance of being endorsed by the WTO Membership.

Prima facie, one is prone to wonder why would the US agree to compensate Brazil, and not simply face retaliation. First of all, Brazil is not a small player, it is ‘smaller’ than the US, but not small. It seems though that it is the US cotton lobby that forced this ‘solution’ on the government, since it was unwilling to give up on the generous subsidies it received, and the government might have feared a backlash if ‘innocent bystanders’ would have to pay for the US cotton industry’s sins.<sup>101</sup>

There is some additional evidence supporting the view that the end game (countermeasures) is de facto reserved for players with more or less equal bargaining power that pre-dates US-Upland Cotton. Bagwell et al. (2005) check all cases between 1995-2005 and find no case where complainant has had to have recourse to countermeasures in order to secure compliance by defendants with ‘less’ bargaining power. They divide the WTO world between OECD- (Organization of Economic Cooperation) and nonOECD members and then ask the question what has been the attitude of complainants when faced with noncompliance by the defendant. They identify a number of cases (less than twenty) where nonOECD complainant has been faced with non-compliance (that is, cases where the WTO was not notified of a change in policy). The OECD defendant did not comply in each of these cases, and yet the complainant did not go ahead and suspend concessions. On the other hand, they find no case where an OECD complainant has had to exercise threat (by suspending concessions) in order to induce compliance by a nonOECD defendant. This observation falls squarely within Schelling’s (1960) classic account that for the threat to be credible, it does not have to be exercised. This study provides some empirical proof that bargaining asymmetries might matter when it comes to discussing compliance at the WTO.<sup>102</sup>

Ecuador’s case is quite telling to describe instances where ‘smaller’ players attack the ‘big guns’.<sup>103</sup> Having won three disputes against the EU, and been authorized to impose countermeasures up to a value of \$261 million (\$200 of which in TRIPs), it decided against imposition of countermeasures. Although it never revealed the reasons for doing so, one can imagine that it might have realized that not only it would not be in position to recoup the damage done (so why invest in countermeasures in the first place?), but its actions, in the realm of violations of intellectual property rights (cross-retaliation), could have provoked Zoellick-type reaction as previously discussed.<sup>104</sup>

Huerta-Goldman (2009) in similar vein, provides evidence to the effect that Mexico did not retaliate against the EU in the same dispute, opting for better terms in its on-going negotiation that led to the conclusion of the free trade area between Mexico and the EU.

The EU though, eventually did reach an agreement with bananas exporters, even though Ecuador never exercised its right to retaliate.<sup>105</sup> The balance of rights and obligations was not re-established, and Ecuador is definitely a loser in this story. But the EU also accepted a cut. When granted the right to impose countermeasures worth over \$4billion in the US-FSC dispute, it suspended concessions for only a small fraction of the total sum. Once again, it is clear quantification of damages will show that the original balance of rights and obligations was not respected in any of the cases discussed here. Overall nevertheless, losses are capped and distributed (even though unequally) to the membership. The flavour here yet again is reminiscent of diffuse reciprocity. The fact that losses are not as dramatic as they could be in case retroactive remedies were routinely recommended helps. In this vein, we

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<sup>101</sup> The EU executive did not have similar fears when implementing its bananas-policy, as Hoekman and Mavroidis (2014) explain.

<sup>102</sup> It is this observation that prompted the authors to propose the introduction of tradable remedies in the WTO in Bagwell et al. (2011).

<sup>103</sup> A series of papers cited in this paper, both theoretical as well as empirical, and most recently Bown and Reynolds (2015), prove that bargaining power does matter.

<sup>104</sup> Bown (2002), (2004), and Blonigen and Bown (2003) show why governments may be more likely to implement policies that violate the WTO, if they are not too worried about the retaliation capacity of the potential complainant.

<sup>105</sup> Guth (2012).

should include a reference to the US-Upland Cotton (Article 22.6-US) arbitration. There the Arbitrator moved away from the prior benchmark for calculating the amount of retaliation to a new, lower benchmark. Before this case, affected parties could request the right to retaliate for the whole amount of an illegal (e.g., export-, local content-) subsidy paid. Indeed, this is what had happened in US-FSC. Following this case, affected parties can only retaliate up to the level of trade damage suffered. Since say export subsidies concerns goods sold worldwide, it is expected that the new, trade effects-based standard will lead to lower levels of retaliation.<sup>106</sup>

### **5.3 Constraining Punishment**

In the first two parts of this Section we have established that in practice WTO members use exclusively the multilateral dispute settlement procedures even though they will not be fully compensated, since they will recover only part of the damage that they have suffered. Was not the US worrying exactly about the same issues when having recourse to Section 301? What has changed then? Why is recourse to unilateral measures unheard of in today's world? One thing has changed. Punishment is constrained for all.<sup>107</sup> By being obliged to submit exclusively to the WTO, trading nations have agreed to abandon being the judge of their own cause and to abide by whatever third party adjudication will decide. In the altar of compulsory third party adjudication, they were prepared to collectively sacrifice some of the trade concessions they extracted from their partners. Constraining punishment emerges as the single most important contribution of the WTO dispute settlement system, a conclusion very much in line with the negotiating intent that we discussed in Section 2.

Constraining punishment is the quintessential, but not the only feature of the regime. The WTO judge, it has been argued,<sup>108</sup> 'completes' the contract by interpreting open-ended terms, and making the resolution of future disputes (more) predictable. This is especially the case, because, as of the advent of the WTO, the AB has been introduced. The AB is by construction limited to interpretation of legal issues, and legal issues cut across disputes. There are reasons to doubt that this function was equally important to that of curbing unilateral punishment.

First, the AB was not heavily negotiated, it was more of an afterthought. For some, it was a necessary counter-balance to compulsory third party adjudication, some sort of insurance policy that judicial errors (of whatever type) will be avoided, or at least reduced. The fact that only one article of the DSU is dedicated to the highest organ of dispute adjudication is proof enough that this has indeed been the case.<sup>109</sup>

Second, it is very debatable whether it does 'complete' the contract in the sense that theorists understand this function. Numerous reports prepared by the reporters of the American Law Institute (ALI), the only forum that has been scrutinizing the output of the AB, point to unjustified

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<sup>106</sup> There are of course, also cases where nonimplementation was not necessary precisely because the threat was credible. This is essentially the argument in Bagwell et al. (2005). In similar vein, Ehring (2014) describes all instances in which the EU was authorized to impose countermeasures and shows why it did not take concrete steps in several of them. Following the condemnation of the US in US-Steel Safeguards, the EU had targeted goods in swinging states about the time when the US general election would take place. The US administration withdrew the challenged measures in time avoiding the costly EU retaliation.

<sup>107</sup> The US has of course managed to also persuade its trading partners to adopt multilateral rules regarding trade in services, and protection of intellectual property rights. This must have weighed in in its decision to abandon aggressive unilateralism à la Section 301.

<sup>108</sup> Horn et al. (2011).

<sup>109</sup> Van den Bossche (2006) provides ample evidence to this effect.

inconsistencies across judgments, abandoned interpretative efforts etc. If at all, ‘completion’ has occurred in some areas, while confusion still reigns in others.<sup>110</sup>

The framers of the DSU paid little time in designing the entities that would adjudicate, but precious time in putting in place a system of compulsory third party adjudication.

## **6. Dissecting Section 301**

The main conclusion of this paper is what mattered most to the negotiators of the Uruguay round was to establish a spirit of cooperation and restrain trade wars. Section 301 threats were looming large, and the common effort was to introduce a regime that would put an end to unilateral enforcement. The possibility to block access to justice and/or retaliation and the statutory deadlines agreed, along with the introduction of services trade and protection of intellectual property rights, were the quid pro quo for US to stop unilaterally enforcement. Subsequent practice shows that, whereas contrary to the statutory imperative the original balance of rights and obligations is not reestablished by the Arbitrators entrusted with deciding on the level of permissible retaliation, WTO members continue to submit their disputes to the WTO and nowhere else. They live happily in a world of diffuse reciprocity, where they receive less than what they had bargained for but are not subjected anymore to unilateralism. Ethier (2004) was probably the first who got it right when stating that the purpose of WTO dispute settlement system:

is not to facilitate punishment, it is to constrain it.

The discussion and empirical analysis in this paper subscribes to this conclusion.

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<sup>110</sup> And as Maggi and Staiger (2011) explain, some litigation might be happening simply because of past failures and/or inconsistencies of panels and the AB.

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## Annexes

### Annex I: duration of process

	Statutory	Actual
Consultations	60 days	164 days
Panel	180-270 days	445 days
AB	60-90 days	91 days
Compliance Panel	90 days	253 days
Compliance AB	60-90 days	88 days

### Annex II: Recourse to Article 22 of the DSU (1 January 1995–2 January 2016)

Name of Dispute	Complainant	Defendant	Retaliation Level
EC-Bananas III (Ecuador)	Ecuador	EU	\$201,6mio/year
EC-Bananas III (US)	US	EU	\$191,4mio/year
EC-Hormones (Canada)	Canada	EU	\$11,3mio/year
EC-Hormones (US)	US	EU	\$116,9mio/year
Brazil-Aircraft (Canada)	Canada	Brazil	\$344,2mio/year
Canada-Aircraft (Brazil)	Brazil	Canada	\$247,797mio/year
US-FSC (EC)	EU	US	\$4,043mio/year
US-1916 Act (EC)	EU	US	Trade effect coefficient
US-Offset Act (Brazil et al.)	Brazil et al.	US	Trade effect coefficient
US-Gambling (Antigua)	Antigua	US	\$21.2mio/year
US-Upland Cotton (Brazil)	Brazil	US	\$147.3mio/year
US-COOL (Canada)	Canada	US	\$1,054,729mio/year
US-COOL (Mexico)	Mexico	US	\$227,758mio/year

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